Supreme Court, U.S.
FILED
MAY 7 1996
CLERK

(3)

No. 95-1420

In The

SUPREME COURT OF THE UNITED STATES

October Term, 1995

PHILIP MORRIS INCORPORATED,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Second Circuit

REPLY BRIEF FOR PETITIONER

JEROME B. LIBIN
(*Counsel of Record*)
WILLIAM S. COREY
DAVID A. GOLDEN

SUTHERLAND, ASBILL & BRENNAN
1275 Pennsylvania Avenue, N.W.
Washington, D.C. 20004
(202) 383-0100
Counsel for Petitioner

May 7, 1996

RECEIVED
HAND DELIVERED
MAY - 7 1996
OFFICE OF THE CLERK
SUPREME COURT, U.S.

RULE 29.6 STATEMENT

There has been no change in the information provided in the Rule 29.6 Statement in the Petition.

No. 95-1420

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1995

PHILIP MORRIS INCORPORATED,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ON PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

REPLY BRIEF FOR PETITIONER

Respondent's adroit footwork in her Brief in Opposition cannot conceal the glaring omissions in her analysis.

The reason petitioner realized "gross income" on the repayment of its foreign currency borrowings is because, for U.S. tax purposes, those borrowings were required to be

treated as if they were U.S. dollar borrowings.[1/] Once that rule is acknowledged -- something respondent has not been willing to do -- it becomes clear that the Sixth Circuit reached the correct result in Kentucky & Indiana Terminal R.R. v. United States, 330 F.2d 520 (6th Cir. 1964).

It is true, as respondent states, that a change in exchange rates enabled petitioner to repay its indebtedness with currency having a lower dollar value than the value of the currency it borrowed. But that fact only explains the economic result of repayment. Petitioner derived "gross income" on repayment under the rule of United States v. Kirby Lumber Co., 284 U.S. 1 (1931) -- the repayment of a debt for less than its face amount gives rise to gross income.

Recognizing the force of the foregoing, respondent asserts that "if the amount repaid by the borrower is the full amount required to be paid under the terms of the original loan agreement -- as in the present case -- there is no income from the discharge of indebtedness under Section 108. [citation omitted]." (Resp. Br. 7.) Respondent then concludes that "petitioner did not settle its foreign debts for less than, or otherwise at a discount from, their par or face amounts." (Resp. Br. 10.)

Contrary to respondent's assertion, petitioner's foreign currency borrowings were U.S. dollar borrowings for U.S.

[1/] See Gillin v. United States, 423 F.2d 309, 313 (Ct. Cl. 1970); National-Standard Co. v. Commissioner, 80 T.C. 551, 563-64 (1983), aff'd 749 F.2d 369 (6th Cir. 1984); America-Southeast Asia Co. v. Commissioner, 26 T.C. 198, 200 (1956).

tax purposes, not "foreign debts." More importantly, petitioner did not repay its foreign currency borrowings "in full" or at their "face amounts" for U.S. tax purposes simply because it returned the exact number of foreign currency units it had borrowed. (Resp. Br. 7-8, 10.) For U.S. tax purposes, when foreign currency is borrowed, the "full amount required to be paid" is the U.S. dollar value of the foreign currency when borrowed. The "amount repaid" is the U.S. dollar value of the foreign currency when repayment is made. Where, as here, the latter is less than the former, ordinary income is realized because the creditor accepts in repayment currency with a lesser dollar value than the dollar value of the currency it loaned.[2/]

Respondent's conclusion that petitioner paid its debts in full is not only erroneous, but also diametrically opposed to respondent's position as upheld in America-Southeast Asia Co. v. Commissioner, 26 T.C. 198 (1956). In that case, the Tax Court ruled that the gain realized as a result of currency fluctuations at the time of repayment of a foreign currency borrowing incurred to purchase goods was ordinary income, not capital gain, because it was "a gain arising directly out of petitioner's trade or business from the settlement of a debt incurred therein for less than its face amount. . . . See United

---

[2/] Indeed, respondent's simplistic "units for units" analysis leads to the logical conclusion that petitioner realized no income at all on repayment of its foreign currency borrowings. B.F. Goodrich Co. v. Commissioner, 1 T.C. 1098 (1943), acq. 1943-1 C.B. 10 (withdrawn), nonacq. 1974-2 C.B. 5.

States v. Kirby Lumber Co., 284 U.S. 1 (1931) [other citations omitted]." Id. at 200-01 (emphasis added).

Respondent does not indicate precisely why this Court's decision in United States v. Centennial Savings Bank FSB, 499 U.S. 573 (1991), has caused her to change her position on this point and conclude that petitioner settled its debts at their face amounts.

* * *

The Second Circuit below felt it had no choice but to apply the holding of Centennial on a literal basis. The court ruled that in the absence of a negotiated release petitioner's indebtedness was not "discharged" within the meaning of section 108. Yet, the court evidenced strong doubts about the propriety of the result it reached. It also recognized that in dollar terms -- the only terms relevant for U.S. tax purposes -- petitioner did indeed settle its debts for less than their face amount, precisely as contemplated by the legislative history of section 108.[3/] (Pet. App. 12a-13a.)

The issue presented by the petition for certiorari is whether this Court can properly ignore the square conflict between the Second and Sixth Circuits caused by its decision in Centennial. Surely the existence of such a conflict, attributable entirely to this Court's intervening decision that admittedly did not consider the application of section 108 in

---

[3/] While there was in fact no negotiated release or forgiveness here, that is also true in the case of open market repurchases of bonds, as in United States v. Kirby Lumber Co., 284 U.S. 1 (1931), the very case that led to the enactment of section 108.

the context of foreign currency borrowings, requires an exercise of this Court's supervisory powers to resolve the conflict regardless of subsequent statutory amendments.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

JEROME B. LIBIN
(*Counsel of Record*)
WILLIAM S. COREY
DAVID A. GOLDEN

SUTHERLAND, ASBILL & BRENNAN
1275 Pennsylvania Avenue, N.W.
Washington, D.C. 20004
(202) 383-0100

Counsel for Petitioner

May 7, 1996